



STATE OF COLORADO

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State Auditor

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November 26, 2003

Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

Members of the Legislative Audit Committee:

We have audited the financial statements of the State of Colorado, as of and for the year ended June 30, 2003, and have issued our report thereon dated November 26, 2003. We conducted our audit in accordance with generally accepted auditing standards applicable to financial audits contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the State of Colorado's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Governmental Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State of Colorado's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the State of Colorado's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as Recommendation Nos. 2-7, 11-12, 14-15, 21, 24, 63-64.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose the reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness.



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**Independent Auditor's Report on Compliance
With Requirements Applicable to Each Major Program
and Internal Control Over Compliance
in Accordance With OMB Circular A-133**

Members of the Legislative Audit Committee:

Compliance

We have audited the compliance of the State of Colorado, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133, *Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2003. The State of Colorado's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the State of Colorado's management. Our responsibility is to express an opinion on the State of Colorado's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of State, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the State of Colorado's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the State of Colorado's compliance with those requirements.

In our opinion, the State of Colorado complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2003. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as Recommendation Nos. 27-30, 33-58, 60-62, 65-73, 75.

Internal Control Over Compliance

The management of the State of Colorado is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the State of Colorado's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the State of Colorado's ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as Recommendation Nos. 31-57, 59, 61-64, 69, 73-76

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.



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November 26, 2003

Required Communications Letter

Members of the Legislative Audit Committee:

We have audited the financial statements of the State of Colorado for the year ended June 30, 2003, and have issued our report thereon dated November 26, 2003. Under auditing standards generally accepted in the United States of America, we are providing you with the following information related to the conduct of our audit.

Our Responsibility Under Auditing Standards Generally Accepted in the United States of America

We have a responsibility to conduct our audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States. In carrying out this responsibility we planned and performed our audit to obtain reasonable assurance about whether the State's financial statements are free from material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements, due to error or fraud, may exist and not be detected by us. We have no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by error or fraud, that are not material to the financial statements are detected.

In addition, we obtained an understanding of the State's internal control sufficient to plan the audit and determine the nature, timing, and extent of audit procedures to be performed for the purpose of expressing our opinion on the financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control.

Significant Accounting Policies

The significant accounting policies used by the State are described in the notes to the financial statements. During the year ended June 30, 2003, there were no significant changes in previously adopted accounting policies or their application.

Management Judgements and Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based upon management's current judgements. Those judgements are normally based on knowledge and experience about past and current events and on assumptions about future events. Significant accounting estimates reflected in the State's Fiscal Year 2003 financial statements include taxes receivable, allowance for doubtful accounts, depreciation of capital assets, deferred revenue, compensated absence liabilities, self-insurance liabilities, unclaimed property liabilities, scholarship allowances, and unemployment benefits payable. We evaluated the key factors and assumptions used to develop these estimates and determined that they are reasonable in relation to the financial statements taken as a whole.

Audit Adjustments

Professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgement, may not have been detected except through our auditing procedures. Uncorrected misstatements identified during the Fiscal Year 2003 audit were determined by management and the Office of the State Auditor to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole. The net effect of the uncorrected misstatements would have been to increase the fund balances by about \$2 million, decrease assets by about \$1.5 million, increase liabilities by almost \$1.5 million, decrease revenue by about \$1.3 million, and increase expenditures by about \$3.7 million. See Appendix B, which shows the net and gross passed audit adjustments by agency and the net and gross posted audit adjustments by agency.

Disagreements with Management

Professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning financial accounting, reporting, or auditing that could be significant to the financial statements or the auditor's report.

The Fiscal Year 2003 financial audit of Colorado State University (CSU) was conducted by KPMG LLP under contract with the Office of the State Auditor. There were two initial disagreements with management at CSU on financial and reporting matters which were ultimately resolved. Those disagreements were as follows:

- *Start-up Costs and Cost Share Accruals.* Management initially recorded expenses and related liabilities for future start-up costs and CSU's portion of future cost share arrangement costs. KPMG believed that these accruals should not have been made due to the fact that the amounts being accrued were actually *future* costs and the expense and related liability had not actually been incurred. After much discussion, management subsequently made adjustments to remove the start-up cost and cost- share accruals totaling approximately \$8,337,000 and \$3,801,000 respectively. KPMG and the Office of the State Auditor concur with the final resolution of this issue and the final correction to the financial statements.

- *Restricted Net Assets for TABOR.* Management recorded restrictions on net assets for the portion of enterprise net assets that were subject to TABOR due to the fact that management believed that the TABOR “cap” acted as a constraint on these funds at year end. KPMG disagreed with this restriction due to the fact that TABOR only applies temporary constraints on these net assets and the characteristics of the TABOR constraints on these assets do not meet the definition of “restricted” per GASB Statement No. 34, *Basic Financial Statements and Management’s Discussion and Analysis for State and Local Governments*. After much discussion, management subsequently made an adjustment to move this portion of net assets from the “restricted” designation to the “unrestricted” designation. KPMG and the Office of the State Auditor concur with the final resolution of this issue and the final correction to the financial statements.

Consultations with Other Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to confer with us to determine that the consultant has all relevant facts. To the best of our knowledge, there were no such consultations, written or oral, from other independent accountants during the past year.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

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This report is intended solely for the information and use of the Legislative Audit Committee, and the State's management and is not intended to be and should not be used by anyone other than these specified parties.